Standard Chartered

European Banking Authority
20 Avenue André Prothin
92400 Courbevoie, France.

30 September 2019

**Standard Chartered's response to draft guidelines on loan origination and monitoring.**

Dear Sir/Madam,

Standard Charted Bank ("SCB" or "The Bank") welcomes the opportunity to comment on the European Banking Authority ("EBA") draft guidelines on loan origination and monitoring. We support the guidelines' policy objective to ensure that institutions have robust and prudent standards for taking, managing and monitoring credit risk. These guidelines would complete other EU policies and initiatives to tackle the issue of high level of non-performing loans ("NPLs"), concentrated in few EU countries. However, in their current form, the guidelines would not noticeably improve loan origination and monitoring for large and internationally active EU banks, which already have low NPLs ratios and are subject to significant supervisory scrutiny. Moreover, they may result in certain unintended consequences, such as:

- Risk diverting banks and supervisors' resources to non-material issues;
- Limit EU banks' ability to support financial inclusion;
- Pose risks to the financial stability by favoring lending outside of the banking sector;
- Limit EU banks' ability to compete with banks headquartered in third countries and with Fintech / Big Tech firms offering financing services.

More pointedly, the proposed guidelines may curtail lending to retail and to small and medium enterprises (SMEs), businesses which are critical to the financing of the economy, because of their extra-territorial scope and lack of proportionality. We recommend three main adjustments to reduce the risk of unintended consequences while supporting the guidelines' policy objective:

(1) limit the scope of application to EU originated loans and advances for retail and SME lending (questions 1);

(2) replace the proposed "consumer" and "professional" categories by "retail & SME" and "corporate" (question 1); and

(3) recalibrate the requirements for these revised categories, reserving the most advanced requirements to material lending to corporate (questions 3, 4, 7, 8 and 12).

We provide detailed feedback and recommendations under each of the consultation questions.

Yours sincerely,

Farisa Zarin, Global Head, Regulatory & Public Affairs

## Comments on Draft Guidelines on loan origination and monitoring

30 September 2019

***Question 1: What are the respondents' views on the scope of application of the guidelines?***

**The scope should only apply to loans and advances originated in the EU for retail and SME lending and should exclude all wealth and private banking lending. The proposed "consumer" and "professional" categories should be revised. Several areas require further clarifications and refinements to reduce interpretation uncertainties.**

Recommendation 1: Apply the requirements to loans and advances originated within the EU for retail and SME lending.

The proposed scope, with presumably an extra-territorial reach, combined with the prescriptive and granular nature of the guidelines raise concerns about the ability of EU banks to compete with non-EU banks in third countries jurisdictions. While we are not suggesting that the proposed requirements should be lowered to a point that would undermine the policy objective of the guidelines to support the competitiveness of EU banks, we believe that some adjustments should be made to the various sections of the guidelines. We provide detailed feedback and recommendations under our responses to each question. On Section 2 ("subject matter, scope and definitions") specifically, we suggest limiting the scope to loans and advances originated in the EU for retail lending and SME lending. While it may be justified to apply the guidelines to material lending to large corporates originated outside of the EU due the international nature of the business, this is not the case for retail and SME segments. Retail and SME lending are driven by local specificities and there is a high degree of disparity between markets' characteristics (competitive and regulatory landscape, customer profile, infrastructures, etc.). Granular and prescriptive standards and guidance do not work under such circumstances and can result in unintended consequences. We note that several areas of the Basel III Final framework, such as guidance on underwriting policy or the assessment of the borrower's ability to repay, are left to national discretion. Retail and SME markets of Member States are likely to be more homogeneous, which supports the application of the guidelines when originated in the EU. However, retail and SME markets in the rest of the world in which large EU bank operates will be very heterogenous as those are at different stages of development and maturity.

Recommendation 2: Exclude wealth lending, private banking and other fully collateralised lending for retail and SME from the scope of application.

We also think that the final guidelines should exclude wealth and private banking lending and other fully collateralised lending (e.g. cash backed) in retail and SME altogether for two reasons. First, the guidelines do not cover "financial collateral" and focuses instead on immovable and movable property collaterals (paragraph 11). Wealth and private banking lending commonly involve financial collateral such as equities, bonds, mutual funds or life

insurance contracts. Second, the heavily collateralized nature of those businesses means that most of the proposed requirements will not be relevant. We provide more details on this point under Questions 7 and 8.

Recommendation 3: Replace the "consumers" and "professional" categories by "retail & SME" and "corporates" and adjust the guidance to the revised categories.

The proposal attempts to introduce proportionality by setting different sets of requirements for "consumer" and "professional" (as defined under paragraph 17). We have several issues with the two categories and related requirements:

i. The definition is open to interpretation. We would presume that "consumer" refer to individuals and "professional" to any other counterparty types. However, the guidelines do not offer certainty on this;

ii. The "professional" category, regardless of interpretation differences, is likely to include a wide range of counterparties, from small partnerships and SMEs to large multi-national corporates. We fail to see how applying the same requirements across such a wide range of counterparties is sensible and consistent with the principle of proportionality;

iii. There is a risk that the granular and prescriptive nature of the guidelines could result in a disproportionate number of the banks and supervisors' resources spent on non-material issues;

iv. The requirements for the "consumer" category are mis-calibrated for developing markets and not compatible with the use of emerging technologies.

Recommendation 4: Define "renegotiated" as amendments to terms of loans and advances agreements which result from a credit event materially impacting the counterparty.

The meaning of "renegotiated" is not clear, which could lead to a range of interpretations and a lack of consistent implementation between different banks and between different supervisors. Full certainty on the definition is critical as it will determine loans and advances which would be in scope of Section 5 ("Loan origination procedures"). The guidelines should also make clear that refinancing or annual review of loans and advances pre-dating the guidelines effective date are not in scope of Section 5.

Recommendation 5: Clarify whether sections 5 and 6 are applicable to financial corporates (e.g. fund, finance and leasing company).

We seek confirmation on whether financial corporates are in scope of the Sections 5 and 6 ("Pricing"), or part of the exempted counterparties list per paragraph 9 Section 2.

Recommendation 6: Clarify that loans and advances include trade finance and export finance as suggested under paragraph 129 of section 5.

For clarity, we would suggest indicating under Section 2 that trade finance and export finance are in scope, as mentioned under paragraph 129 of Section 5 ("Loan origination procedures").

Recommendation 7: Remove the need to comply at the sub-consolidated level.

We would welcome clarification on supervisory expectations to evidence compliance at the sub-consolidated level. While compliance at the consolidated and the individual levels could be demonstrated by having effective policies in place for the Group and for banking subsidiaries within the Group, evidencing compliance at the sub-consolidated level is unclear. We would recommend that material compliance at the Group and at the individual level is sufficient. Consistent with our recommendation to limit the scope of the guidelines to EU originated loans for retail and SME counterparties, we would suggest exempting non-EU individual entities from the requirements for those counterparties.

Recommendation 8: Align the classification of "housing rental" and "commercial real estate loan" to the CRR.

On the definitions section, there is an inconsistency in the definition of Commercial Real Estate ("CRE") and Residential Real Estate ("RRE") between the draft guidelines and the existing Capital Requirements Regulation ("CRR"). The draft guidelines classify "rental housing" under CRE while the CRR classifies it as "RRE". We would also propose that CRE loan should not be limited to loans extended to a "legal entity" as it is possible for individuals to invest in CRE. The draft guidelines classification should be aligned to CRR.

**Question 2: Do you see any significant obstacles to the implementation of the guidelines by the application date and if so, what are they?**

***The proposed application date should be extended to allow enough time for EU banks to materially comply with the guidelines.***

Recommendation 1: Set the application date at 31 December 2022.

The proposed application date of 30 June 2020 will only leave about 6 months for EU banks to prepare for compliance given that the final guidelines are expected to be published at the end of 2019. A 6 months implementation period would be too short given the proposed extensive coverage of the guidelines and their granular nature. Implementation of the requirements under section 5 ("Loan origination procedures") only would demand significant documentation, process and system changes such as the alignment of applications documentation and decisions systems to the requirements across impacted retail/ SME products and retail/SME markets (25 for SCB). We believe that 31 December 2022 would be a more reasonable implementation date for international EU banks to achieve material compliance. We stress, however, that the implementation would be costly without materially improving the loan origination and monitoring processes. For this reason, we do not support a full implementation of the guidelines as proposed. A shorter implementation timeline would be appropriate if our key recommendations listed under Question 1 were reflected in the final guidelines.

Other areas of the guidelines, such as sub-section 4.3.4 ("Environmental factors and green lending") would also require longer implementation timetable. Climate change is certainly a key consideration for large EU banks, including for SCB which is committed to the Paris Agreement and announced in September 2018 that it would stop the financing of new coal-fired power plants anywhere in the world. However, large banks have only recently started developing plans to operationalise more specific climate-change risks such as physical and transition risks, into their credit processes. The operationalisation will require ongoing dialogue with the supervisor and is expected to be a multi-year effort (2 years in SCB's

case). In general, the topic of climate-change risk is at an early stage of development and it will take time to firm up a fair, workable and harmonised approach in the EU and at the international level. While the EU is leading on the topic as demonstrated by the Taxonomy proposal from the Technical Expert Group ("TEG") on sustainable finance, some other key markets have yet to come up with a proposed framework.

**Question 3: What are the respondents' views on whether the requirements set in the draft guidelines are future proof, in particular in relation to technology-enabled innovation (Section 4.3.3) and environmental factors and green lending (Section 4.3.4)?**

***The draft guidelines could limit EU banks' ability to innovate, making them vulnerable to competition from new Fintech/ Big Tech companies and third country banks. This could, in turn, be detrimental to financial stability by pushing financing services to non or less regulated entities.***

Recommendation 1: Include other conventional forms of credit analysis such as scorecard and decisioning systems into the guidelines.

We do not have significant concerns with the general principles on technology-enabled innovation (sub-section 4.3.3). However, the requirements set through other sections of the draft guidelines, especially under Sections 4 ("Governance requirements for credit granting and monitoring") and 5 ("Loan origination procedures") lack the necessary flexibility to support financial innovation by banks; in that sense, there are certainly not future proof. This is quite apparent for retail business, where the draft guidelines would deem some conventional credit assessment methods such as customer behavioral analysis as non-compliant. Not only are these methods well-tested and established, but they can benefit from changing technologies and data enrichments. With the exponential increase in data on individuals, those methods are increasingly valuable, allowing cheaper, easier and wider access to financing by individual while supporting prudent credit decisions. A strict application of the guidelines would prevent EU banks to explore and design more efficient credit processes with the risk of lagging behind competitors not in scope of the requirements, either fintech/ big tech firms or banks located in third country jurisdictions. For example, in Africa, mobile banking provides small loans to consumers repayable within 24 hours without any credit assessment. The guidelines should not risk favouring the move of some lending activities to Fintech and BigTech firms with associated risks to financial stability, as well as concerns on competition and data privacy.

The proposed guidance on environmental factors and green lending (sub-section 4.3.4) is conceptually sound but we would caution that the topic of sustainable finance is at an early stage of developments and is expected to evolve. The EU TEG on sustainable finance has only recently proposed a Taxonomy, which has received support from the Industry but raised concerns due to its restrictive nature and may be materially revised in its final version. Also, The EBA, the EIOPA and the ECB are all members of the Network for Greening the Financial System ("NGFS") and we would expect future discussions to inform the content of the guidelines. Finally, many jurisdictions are not as advanced as the EU in developing a local sustainable finance framework, implying that the international policy landscape is subject to change.

Recommendation 2: Include human rights risk related guidance.

We would suggest including into the final guidelines references to human rights risks, especially given on going work by the OECD on “Due Diligence Guidance” for corporate lending and underwriting which articulate expectations on human rights for all financial institutions doing business in OECD member states.

### Question 4: What are the respondents’ views on the requirements for credit risk policies and procedures (Section 4.3)?

***The credit risk policies and procedures requirements should be more proportionate for retail and SME lending. Clarification on MF/ TF requirements is needed.***

Recommendation 1: Differentiate the requirements along the revised categories in Question 1 (i.e. retail & SME; corporate) and reserve the most sophisticated requirements to material lending to large corporate, including for environmental factors and green lending.

While the principles under the section are conceptually sound, the minimum requirements for the content of those policies and procedures (paragraph 35) are overly prescriptive and granular for retail and SME lending businesses. For instance, it is impractical to comply with the credit decision documentation requirements (paragraph 35 (i)) or to consider all the credit granting criteria (paragraph 35 (b) – Annex 1) for scorecard-based credit decisions. We would therefore recommend that the final guidelines remove wording leaving no flexibility (i.e. “should specify at least” under paragraph 35). Annex 1 should be restructured along the business categories we proposed in our answer to question 1 and the related credit risk policies and procedure items re-assessed under those categories.

More proportionality should be introduced in sub-section 4.3.4 (“Environmental factors and green lending”) to ensure that the requirements would apply to material lending to corporates only (and not to SMEs). The current proposal to apply all requirements to “professionals” (paragraph 49. b) fails to deliver adequate proportionality as the category would presumably include all counterparties type except individuals (see our responses to Question 1 for more details). It is not reasonable to expect the same level of information and due diligence on climate-related items for SMEs and large corporates.

Recommendation 2: Clarify that MF/ TF policies and procedures do not need to be embedded into the credit policies and procedures to comply with the guidelines.

Section 4.3 also covers anti-money laundering and counter-terrorist (ML/ TF) policies and procedures under paragraphs 32 and sub-section 4.3.1. We are concerned that the guidelines could be interpreted as requiring MF/ TF to be fully embedded into the credit policies and procedures. Credit policies and procedures can inform MF/ TF to some extent, but there are significant limitations in terms of effectiveness and efficiency which justify having standalone MF/ TF policies and procedures. While banks can set and enforce policies and procedures to identify, assess and manage the MF/TF risks to which they are exposed as a result of their credit granting activities (paragraph 40), it remains challenging to fully ensure upfront that the source of any funds the customer will use to service the credit are from legitimate sources as those sources can change over the life of the loan/ before each repayment. It should also be made clearer that most of the information listed under annex 2 will be of limited value to inform MF/ TF (paragraph 41). Finally, we believe that counterparty name (as part of client onboarding) and transaction screenings are more

effective controls for ML/ TF risks than the credit process contrary to what is suggested under paragraph 42. For those reasons, we would recommend amending the language in the final guidelines and make clear that banks can keep their MF/ TF policies and procedures separate from the credit process if effective.

**Question 5: What are the respondents' views on the requirements for governance for credit granting and monitoring (Section 4)?**

***Most of the proposed guidance is adequate if implemented in a proportionate manner by supervisory authorities. The specific proposal on remuneration is not practical.***

Several sub-sections of Section 4 are covered in previous questions. Our comments here therefore address the proposals under sub-sections 4.4 ("Credit decision making") and 4.7 ("Remuneration"). We do not have material comments on other sub-sections.

Recommendation 1: Provide additional guidance on the definition of "small and non-complex credit facilities".

The credit decision making sub-section does not reflect existing practices because it limits the "sole delegated credit authority for credit decisions" to "small and non-complex credit facilities". While the draft guidelines offer neither a definition of nor a methodology to determine "small and non-complex", we would deem that credit decision on retail and SMEs qualifies for the sole delegated authority exemption and would welcome additional guidance on this item.

Recommendation 2: Delete paragraph 82 of sub-section 4.7 ("Remuneration").

The guidance on remuneration policies under sub-section 4.7 is not practical, especially the granular requirements listed under paragraph 82. It is unclear how bank would be expected to determine the adequate period that would link the variable remuneration of the staff involved in credit granting to "long term quality of credit exposures". E.g. would a credit officer responsible for a mortgage portfolio be excepted to have a variable remuneration tied to the average duration of the portfolio, which could be above 15 years. The scope of the requirements in terms of staff is also unclear, e.g. at what level of seniority would the guidance be expected to apply. We recommend deleting paragraph 82 on the basis that the underlying objectives of ensuring the independence in credit decision-making and setting remuneration policies in line with credit risk appetite and strategies are effectively addressed by sub-section 4.4.1 and paragraph 81 of sub-section 4.7.

**Question 6: What are the respondents' views on how the guidelines capture the role of the risk management function in credit granting process?**

No comments.

**Question 7: What are the respondents' views on the requirements for collection of information and documentation for the purposes of creditworthiness assessment (Section 5.1.)?**

***The requirements for collection of information and documentation are too prescriptive and granular to fit with all business models across different markets. The impact of guarantees, collaterals and ownership structure on the requirements should be considered for lending to corporate.***

Recommendation 1: Differentiate the requirements along the revised categories in Question 1 (i.e. retail & SME; corporate) and reserve the most sophisticated requirements to material lending to large corporate.

The proposed "consumer" and "professional" categories are not adequate as explained through our responses. "Professional" would include all non-consumers as per the guideline definition, which will presumably cover a wide range of counterparties from partnership and SMEs to large international corporations. It is hard to see how the granular and prescriptive requirements on information collection and verification of paragraphs 93 and 94 are expected to apply to such a wide range of counterparties. For instance, it is unreasonable to expect the collation of information for SME to be at the same level as for a large corporate. SME generally do not provide business plans and financial projections as required under paragraph 93 e. and f.

Recommendation 2:

- Allow flexibility and a simplified approach for lending to existing-to-bank customers vs. new-to-bank customers for retail and SME lending;
- Allow the use of gross income (instead of only disposable income) for credit assessment of retail and SME counterparties;
- Expand evidence to income (Annex 2) to include income surrogates.

In general, the guidelines assume the same level of availability, accuracy and reliability of information for all consumer segments in mature and in developing markets. For instance, the assessment of disposable income (paragraph 98) may not be practical and gross income should be allowed to be used. Pay slip and other income documentation may not reflect deductions for tax and other financial commitments as required in Annex 2. Income for self-employed consumers would normally be based on bank's statements. A reliable credit bureau may not be available. Additionally, under Annex 2, evidence of income should be expanded to include income surrogates (e.g. net worth or Assets under Management) based assessment and derived income-based assessment where these approaches have proven to be predictive and reliable. Our concerns with this section would be mostly addressed by following our recommendation made under Question 1 to exclude non-EU originated loans and advances from the scope of the guidelines, as compliance with the requirements will be a challenge outside of the EU due to the specific nature of each retail and SME markets.

Recommendation 3: Remove the requirements to build a comprehensive view of all the borrower's credit commitments (single customer view) for unsecured lending.

The general requirements suggest (paragraph 85) that banks should build a comprehensive view of the borrower's financial position, including a view of all the its financial commitments. In the case of unsecured retail lending, this is often not necessary: expecting banks to build up such view would be costly without bringing much benefit to the loan origination process. Partial credit exposure measures, such as Debt-to-Income ratio

("DTI") based on unsecured debt, can be sourced from information readily available in credit bureau markets. This makes DTI easily accessible and reliable. DTI has also proven to be predictive of the borrower's ability to meet its financial obligations. All-encompassing measures, such as Debt Servicing Ratio ("DSR"), are more difficult to source and more prone to error due to assumptions required to calculate the counterparty total monthly obligations.

Recommendation 4: Acknowledge that collateralised and guaranteed lending will reduce the creditworthiness assessment requirements.

The collection and documentation requirements should account for the impact of collateralised and guaranteed on lending to corporate. In the case of heavily collateralised lending for instance, which is common in certain structure transactions, comprehensive information on the borrower would not be a primary concerned. To some extent as well, the ownership structure and the place of the borrower within that ownership structure would also dictate the necessary amount of information to be collected and documented on the corporate borrower.

### Question 8: What are the respondents' views on the requirements for assessment of borrower's creditworthiness (Section 5.2)?

***The requirements for assessment of borrower's creditworthiness are too prescriptive and granular to fit with all business models across different markets. The impact of guarantees, collaterals and ownership structure on the requirements should be considered for lending to corporate.***

Recommendation 1:

- Differentiate the requirements in line with the revised categories (i.e. retail; SME; corporate) and reserve the most sophisticated requirements to material lending to large corporate;
- Allow flexibility and a simplified approach for lending to existing-to-bank customers vs. new-to-bank customers for retail and SME lending;
- Allow the use of gross income (instead of only disposable income) for credit assessment of retail and SME counterparties;
- Allow the use of automatic credit decision systems in addition to "credit decision-making body" for retail counterparties.

Concerns on section 5.2 mirror those highlighted under question 7 on section 5.1 but from a creditworthiness assessment point of view. The "consumers" and "professional" categories and the prescriptive nature of the requirements under each fail to deliver sufficient proportionality and flexibility to make the guidelines fir for purposes in many cases. In addition to issues highlighted under question 7 on the data collection and documentation, we believe that the selected issues below clearly demonstrate the unsuitability and disproportionate nature of the proposed requirements for credit assessment of retail and SMEs borrowers. Requirements to:

i. Perform a full-fledged traditional credit analysis for retail borrowers (paragraph 97 to 99) and no flexibility for simplified approaches (e.g. usage of behavior scorecard and credit bureau) for existing-to-bank retail customers;

ii. Perform a sensitivity analysis for each retail borrower, including variable such as income, interest rate, deferred payments and exchange rates (paragraphs 101, 110, 114 and 121);

iii. Perform a full-fledged traditional credit analysis for SME borrowers, including review of the current and projected financial position under possible adverse scenarios; assessment of the political, economic and legal environment in which the foreign counterparty of the institution's client operates; assessment of the borrower's risk profile vis-à-vis climate related risks (paragraph 126 to 130);

iv. Consider full financial projections, dividend distribution, projected capital and all the metrics listed under Annex 3 (paragraphs 131 to 151) for SME borrowers.

The materiality of individual exposures on retail and SMEs typically does not justify the above requirements and banks generally manage and monitor those exposures (excluding non-performing loans) at aggregate/ portfolio levels, including stress testing and sensitivity analysis. There is also no recognition under sub-section 5.3 of automatic credit decision systems which are commonly used in retail lending: paragraphs 182 and 183 assumes that credit decisions are taken by "the relevant credit decision-making body". The final guidelines should allow for the use of automatic credit decision systems and more generally ensure the requirements retail and SME lending are practical and proportionate.

Recommendation 2: Remove the requirements to assess the borrower's creditworthiness based on all its financial commitments (single customer view) for retail and SME counterparties.

We would also reiterate our comments on Question 7 on the use of partial credit measures for unsecured lending.

Recommendation 3: Acknowledge that collateralised and guaranteed lending will reduce the creditworthiness assessment requirements.

The draft guidelines do not recognise the specificities of collateralised or guaranteed lending. When banks are satisfied with the amount and nature of collaterals or the guarantee, the assessment of the borrower's creditworthiness may not be a primary focus of the credit assessment. Also, in line with our response to Question 7, the ownership structure and the place of the borrower within that ownership structure may significantly influence the conduct of the creditworthiness assessment for corporate borrowers.

Recommendation 4: Remove duplication under section 5.2.7.

We believe that sub-section 5.2.7 on shipping contains the same requirements to consider factor such as supply and demand in the market twice under paragraph 171 c and also under paragraph 172. We would suggest deleting point c under paragraph 171 and keep paragraph 172 and replacing "future trade pattern" by "expected trade pattern".

**Question 9: What are the respondents' views on the scope of asset classes and products covered in loan origination procedures (Section 5)?**

***The loan origination procedures are not suitable for wealth and private banking lending.***

Recommendation 1: Exclude wealth lending, private banking lending and other fully collateralised lending for retail and SME lending from the loan origination procedures requirements.

Please refer to our response to Question 1 for details.

## Question 10: What are the respondents' views on the requirements for loan pricing (Section 6)?

***The proposed requirements would not be compatible with loan pricing and monitoring practices. The one-size-fits-all approach does not consider key difference between syndicated loans to large corporate and bilateral lending to smaller corporate, SME or retail clients.***

Recommendation 1:

- Adopt a more principle-based guidance that would allow banks to explain their pricing and factors of influences;
- Recalibrate the requirements away from "transaction" level toward client and portfolio levels;
- Remove the granular guidance on costs considerations.

The guidelines put emphasis on cost considerations when setting loan pricing. While the cost of capital and cost of funding are key elements of pricing, other non-cost factors often have a significant influence in setting the price. This includes for instance:

i. prevailing market conditions at the time of the transaction, e.g. prevailing risk appetite and positive or adverse sentiment on a specific industry or segment; the demand-supply balance between central bank liquidity and available pool of bank investable loan assets;
ii. pricing mechanism and competition (banks bidding for a specific deal);
iii. whether the transaction is highly commoditized (e.g. retail products), vanilla (e.g. cash loan to corporate) or whether banks provide significant value-add service (e.g. advice on optimal capital structure, maiden market transaction, tailor made funding solutions); and
iv. the overall profitability of the relationship with the counterparty.

While the guidelines briefly touch on the profitability of the relationship under paragraph 188, the other factors are absent from the section. We believe this is a gap that should be addressed in the final text. At the large or syndicated loan level, the decision to provide lending facilities is assessed by banks as part of the overall relationship, and loans may be provided to establish or maintain a broader banking relationship. Banks have various tools to track the reality against these relationship expectations and should be able to justify why lending/pricing decisions were taken. For businesses such as retail, banks would typically monitor the profitability at the product portfolio level instead of the transaction or counterparty level.

The pricing will also be significantly influenced by guarantees, collaterals and more generally by the corporate ownership structure for corporate lending. These elements should be included in the guidelines as key considerations under the pricing section. This is consistent with our comments under Questions 7 and 8, where we have stressed the impact of guarantees, collaterals and of the ownership structure on the assessment of the borrowers' creditworthiness and on data collection and documentation and are integral with the Bank's risk management.

Recommendation 2: Add RoRWA and RoTA as risk-adjusted performance measures.

We would expect Banks to be able to explain their risk-adjusted performance measures rather than having to use one uniform measure and suggest that the risk-adjusted performance measures listed under paragraph 188 should add return on risk-weighted assets ("RoRWA") and return on total assets ("RoTA"), which are commonly used by banks to assets business lines profitability. Many banks do not take administrative cost and fully-loaded Economic-Value-Added ("EVA") or RoTE ("Return on Tangible Equity) to the individual loan or client level, for example in our case, the transmission mechanism used to drive this is a target RoRWA figure which is driven by the RoTE and based on a forward-looking corporate plan.

Recommendation 3: Remove granular guidance around monitoring and review of transaction below costs.

The guidance provided on monitoring under paragraph 190 may not be proportionate depending on the granularity of the loan portfolio in question. Banks tend to review low-returning (below cost of capital/funding) on either a relationship basis or portfolio basis. Only for the largest loan sizes would transaction-level monitoring lead to the right level of management focus on pricing. Profitability or margin analysis are typically conducted at the portfolio and/ or business line levels, especially for high volume transaction businesses, such as retail lending or SMEs lending. The proposed guidance also raises concerns around consistent application, as banks and supervisors may have different interpretations of "below cost".

Recommendation 4: Clarify the definition of "pricing".

The guidelines do not clearly define "pricing", which could therefore be interpreted as all-in pricing (including fees) or interest income only. This should be clarified in the final guidelines.

**Question 11: What are the respondents' views on the requirements for valuation of immovable and movable property collateral (Section 7)?**

***Some of the requirements for the valuation of immovable and movable property collateral would not be fit for all business models across different markets.***

Recommendation 1:

- Allow exemption for rotation requirements for valuers of immovable property collateral for smaller portfolios and where it is justified;

- Be explicit that valuation of movable property collateral (section 7.2.2) is not mandatory;
- Revise paragraph 225 on conflict of interest to specific areas within the control of the institutions.

Some of the requirements for valuers under sub-sections 7.2 and 7.3 will be onerous or not possible to comply with for practical reasons. Importantly, they could go against reasonable and prudent practices. For instance:

i. The need to ensure adequate rotation of valuers on immovable property collateral will not be practical in some markets. This may be due to the small size of the portfolio or the limited availability of reputable valuation offices in developing market. It would be less prudent to force banks to rotate as expected in paragraph 214 and use a less skilled/ qualified valuers;

ii. The valuation requirement for movable property collateral (sub-section 7.2.2) would depend on the type of collateral and this should not be mandatory. For example, this should not apply to vehicle loans;

iii. The requirement for institutions to mitigate any conflict of interest for the valuers (paragraph 225) is onerous. The assignment of the valuer is decided by the valuation agency and the bank would not know if the valuer assigned was related to the buyer or seller of the property. We would propose that this requirement be more specific to what is within the bank's control. For immovable property collateral, the market practice is for a sample check or the use of 2 valuations for the same property.

**Question 12: What are the respondents' views on the proposed requirements on monitoring framework (Section 8)?**

***Some of the proposed requirements on monitoring framework is not suitable for retail and SME lending.***

Recommendation 1: Make the requirements under sub-sections 8.1, 8.2 and 8.4 more compatible with retail and SME lending.

The general requirements under sub-sections 8.1 ("General requirements for credit risk monitoring framework") and 8.2 ("Monitoring of credit exposure and borrowers") and 8.4 ("Monitoring of covenants") are not all suitable for retail and SME lending. Paragraph 231 mandates the monitoring of group of connected clients. Paragraph 234 requires the monitoring and data infrastructure to support a "single customer view". While those requirements can reasonably be expected for material credit exposure to corporate given that EU banks must comply with the large exposure framework, it should not apply for retail and SME counterparties. For those counterparties (excluding non-performing exposures), we monitor retail and SME exposure at the portfolio level (e.g. credit cards, personal loans, mortgage) for portfolio management actions or at the client/ product level for wealth management lending. Other requirements, such as the monitoring of qualitative factors (paragraph 238), the continuous monitoring of the borrower's financial situation and repayment (paragraph 240 and 241) or the monitoring of collateral insurance (paragraph 252) are also more applicable to large corporate. Repayment performance, for instance, feeds into the behaviour scorecard of the borrower as part of the data collection strategy

for retail and SME. The ongoing monitoring of collateral insurance impractical, as retail customer will usually not comply with bank's request once the mortgage loan is granted.

Recommendation 2: Differentiate the requirements in line with the revised categories in Question 1 (i.e. retail & SME; corporate) and reserve the most sophisticated requirements to material lending to corporate

Consistent with the approach adopted through the other section, the monitoring section put forward two different sets of requirements based on the "consumer" and "professional" categories. As mentioned, those categories are not adequate and fail to deliver the necessary proportionality. Sub-section 8.3 ("Credit review of professionals")'s requirements will not be in line with industry practices for SMEs exposures managed under retail segment, as banks commonly rely on behavior scores. Annual credit review of SME borrowers is not needed with regular repayments over a fixed term (e.g. short-term business installment loans, government guaranteed installment loans, loan against property). The requirements under sub-section 8.3 should apply to "corporate" counterparty only.

Recommendation 3: Reserve the "single customer view" requirements for the "corporate" category only.

The requirements to monitor the single customer view for "consumer" is not feasible and will not bring material benefit to the credit monitoring process. It is not market practice to have a single customer view for retail counterparties. There are system and infrastructure constraints as no single system have the capacity of processing and monitoring customer exposures across the various retail products effectively. Refer to our comments and recommendation under Question 7 for details.